This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 PARIS 002298

SIPDIS

PASS FEDERAL RESERVE
PASS CEA
STATE FOR EB and EUR/WE
TREASURY FOR DO/IM
TREASURY ALSO FOR DO/IMB AND DO/E WDINKELACKER
USDOC FOR 4212/MAC/EUR/OEURA

E.O. 12958: N/A
TAGS: EFIN ECON PGOV FR
SUBJECT: FRENCH GDP GROWTH TO SLOW IN THE FIRST HALF

¶1. SUMMARY. GDP growth is likely to slow in the first half of 2005, mainly due to lower consumer spending. Rising oil prices and the appreciation of the euro are curbing investment and exports. Measures recently announced by the government to boost consumption are unlikely to be sufficient to help boost economic growth. END SUMMARY.

GDP Growth Likely to Slow in the First Half

¶2. The National Institute for Statistical and Economic Studies (INSEE) revised upward its Q-1 GDP growth forecast to 2.4% (annualized) from 2.0%, but revised significantly downward Q-2 GDP growth to 1.2% from 1.6%. INSEE's Chief forecaster Michel Devilliers said on March 24 "after a strong rebound from mid-2003 to mid-2004, the economic recovery has become less robust under the shocks of oil and the U.S. Dollar drop." The economy is cooling after expanding 2.3% in 2004, hindered by the highest jobless rate in five years (10.1% in January and February).

¶3. INSEE forecast consumer growth, which accounts for 54% of GDP, to slow to 3.2% (annualized) in Q-1 and to 1.2% in Q-2 from 3.6% in Q-4 2004, which had driven 2004 French GDP growth above average euro zone economic growth rates, notably the German. INSEE explained the slower consumer spending in Q-2 is caused by a decrease in consumer purchasing power due to low job creation, and by higher social contributions to reduce the health insurance deficit.

¶4. According to INSEE, corporate investment will increase 4.9% (annualized) in Q-1, but slow to 3.2% in Q-2 despite low interest rates. Rising oil and raw material prices are curbing global economic growth and corporate profits. Devilliers said that companies are not motivated to increase significantly their investment in France, instead, they are investing abroad to grow.

¶5. Based on European surveys, industrialists are not optimistic about export outlook, notably due to the strength of the euro. INSEE forecast export growth to slow to 4% (annualized) in Q-1 and Q-2 from 5.3% in Q-4 2004.

The Economy Creates Very Few Jobs

¶6. Private and public sector economists agreed that economic growth is creating very few jobs, and consumers' purchasing power will remain moderate. INSEE forecast low job creation of 41,000 jobs in the first half (including 27,000 in the private sector), barely enough to absorb the increase in the labor force. INSEE also forecast a decrease in the unemployment rate to 9.9% by June, not sufficient to achieve the Prime Minister's objective to trim unemployment by 10%, or reduce the rate to less than 9% this year from 10% in ¶2004. Devilliers said that making 9% by the end of 2005 is impossible, since employment increases about 1.6% per year when GDP increases 2.0%.

Inflation Remains Remarkably Moderate

¶7. Although oil prices are reaching records (56.15 USD on March 17), INSEE is confident that inflation will recede to 1.5% in June from 1.6% in February, assuming the cost of the Brent crude oil averages 40 USD a barrel in Q-2. Nevertheless, rising oil prices have a visible impact on prices of manufactured products. Underlying inflation (inflation excluding food, alcohol, tobacco and energy) is increasing, to slightly above 1.5%.

Risks of the INSEE's Scenario are Mixed

¶8. INSEE did not rule out the upside risk of a rebound in

the U.S. economy that would be favorable to the euro zone economy, and thus to the French. INSEE economists also keep in mind that oil prices could stay at 50 USD a barrel in the first half-year. At this level, oil prices would boost inflation and cut GDP growth by 0.1% during the first half-year.

-- --------
GOF Measures in Favor of Consumption will Not Do Much
-- --------

¶9. INSEE did not include in its forecasts measures just announced (on March 23) by Prime Minister Jean-Pierre Raffarin, notably new tax breaks for companies paying profit-sharing bonuses to employees, relaxing access to funds locked in employees savings plans, and the GOF's promise to raise civil servants' wages. Devilliers commented that tax breaks and easier access to savings plans would have a moderate effect on consumption. Only employees working in large companies benefit from profit sharing and savings plans, but not all potential beneficiaries take advantage of the new measures, and in 2004, profit-sharing bonuses became subject to income taxes. Devilliers made a comparison with last year's measures in favor of consumption, saying that only 20% of the tax-exempted gifts to family members directly benefited consumption. The remainder benefited real estate investment or was saved by recipients, resulting, in this case, in a transfer of savings between generations.

-- -----------
GOF Lowers GDP Forecast, but Still Hopes to Achieve 2.5%
-- -----------

¶10. On March 16, Finance Minister Breton cut the GOF 2005 GDP growth forecast to a 2.0-2.5% range from 2.5%, citing the 61% increase in Brent crude oil, and the euro's 5.3% gain against the US Dollar in the past 12 months. Nonetheless, he said that the GOF still hoped for 2.5% GDP growth in 2005.

¶11. Currently, the average 2005 GDP forecast of the Consensus group of 17 banks and institutions, including BNP Paribas and Morgan Stanley, is much lower at 1.9%. Devilliers warned "meeting the lower end of Breton's GDP growth forecast for this year, requires GDP to expand 2.1% (annualized) in Q-3 and Q-4. Meeting the upper range requires GDP growth of 4.8% in Q-3 and Q-4." He advised "France needs to lift structural barriers to create jobs, and boost innovation, and focus on the most promising export markets to grow faster."

Comment

¶12. 2.0% GDP growth in 2005 is more likely than 2.5%, as 4.8% GDP growth in Q-3 and Q-4 looks unrealistic. In the reform field, the law modifying and making the 35-hour workweek more flexible has just been passed. However, the law does not automatically increase the workweek. Companies still have to negotiate longer hours with their employees on a case-by-case basis, which is a practical obstacle to hoped-for productivity gains.

LEACH